IN THE

Supreme Court of the United States

October Term, 1948.

Nos. 795 - 796

IRVING FAINBLATT,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

—o—

LEON FAINBLATT,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writs of Certiorari to the United States Court of Appeals for the Second Circuit.

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To the Honorable Fred M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioners respectfully pray that writs of certiorari be issued to the Court of Appeals for the Second Circuit to review the judgments of that Court.

Statement of Matter Involved.

This is a petition for writs of certiorari to review a decision of the Court of Appeals for the Second Circuit, which affirmed a decision of the Tax Court of the United States deciding that there are deficiencies in the petitioners' respective income taxes for the cal-

endar years 1941 and 1943. The deficiencies result from the Commissioner's determination that each of the petitioners must include in his gross income for the calendar years 1941, 1942, and 1943, one-third of the net income of Lee Sportswear Co., a partnership, for the fiscal years ending within such calendar years. The petitioners have contended in the courts below that each of them properly reported only one-sixth of the partnership income for these years, and that the remaining one-sixths were properly reported by their respective wives.

The petitioners rely solely on the facts found by the Tax Court (R. 6-11). The petitioners are brothers. Since 1929 they and their sister Margaret Horowitz have been equal partners in Lee Sportswear Co., engaged in the manufacture and sale of women's and children's sport clothing and women's work clothing. All three have devoted their full time to the business. In 1931 one Harry Horowitz was employed as the designer and production manager. Horowitz had been in the needle trade industry since 1911, had been in business for himself, was thoroughly experienced, and was from the start a valuable asset to the business. In 1934 he married Margaret Horowitz. At that time the partners offered him a partnership interest, but he refused because he felt it might later create family friction; he continued to work as an employee. However, a few years later he began to feel differently, and he discussed the matter with his wife. She took up the problem with her brothers, but no decision was reached. In 1940 Horowitz finally demanded a partnership interest, letting the others know that he had received such offers from other manufacturers. All of the parties wanted to retain his services, and lengthy discussions were held over several months. The father of the petitioners was the arbitrator of all family disputes, and he participated in these discussions. There was some discussion of Horowitz becoming a one-fourth partner, but he said he would be satisfied with a one-sixth interest coming out of Mar-

garet's share. Margaret, however, felt that by transferring to him half of her interest she would not have an equal voice with her brothers in the management of the company. She then suggested the solution: that she transfer half of her interest to her husband, and that her brothers transfer half of their interests to their respective wives, with powers of management to be retained by her brothers and herself.

In its findings of fact the Tax Court states, "The formation of the partnership was prompted and organized solely by the insistence of Horowitz that he should have a position in the company comparable with those offered to him by other manufacturers" (R. 8). In its opinion the court states, "The transaction before us bears none of the earmarks of an attempt to evade the tax responsibility of the Fainblatt brothers and their sister" (R. 12). Nevertheless, despite the fact that "their entrance into the firm grew out of the emergent necessity of including Harry Horowitz therein", the petitioners' wives were held "not recognized as partners for Federal income tax purposes" (R. 13). The reason was that "they contributed no capital to the business and performed no appreciable services for it", and that "their inclusion in the partnership did not alter the economic status of their husbands as joint producers of the income" (R. 12).

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code. Judgments were entered herein by the Court of Appeals on February 15, 1949 (R.). No petitions for rehearing were filed.

Opinions Below.

The memorandum opinion of the Tax Court, printed in full in the record (R. 4-13), is not officially reported, but appears in C. C. H. Dec. 15,843 and P-H ¶47,153. The Court of Appeals affirmed in open court (172 F. 2d 389; R.).

Specification of Error to Be Urged.

The Court of Appeals erred in affirming the decisions of the Tax Court which were based upon the erroneous rule of law that the validity of a partnership is determined solely by the nature of the capital or services contributed by a partner.

Reasons for Granting the Writs.

1. The rule of law announced by the Tax Court, and sustained by the Court of Appeals, is in conflict with the principles announced by this Court in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293.

2. The decision of the Tax Court, affirmed by the Court of Appeals, is in direct conflict with decisions of other Courts of Appeals, including a decision of the Court of Appeals for the Fifth Circuit in which this Court has granted certiorari. *Culbertson* v. *Commissioner,* 168 F. 2d 979, cert. granted 335 U. S. 883.

3. The question decided by the courts below has been frequently litigated and is an important question of federal law which has not been, but should be, settled by this Court.

4. The rule of law adopted by the courts below, to the effect that an ultimate fact (*i. e.,* the validity or "reality" of a partnership) may be found on the basis of any single fact (*i. e.,* the nature of the capital or services contributed by a partner), to the exclusion of all other relevant facts, is so great a departure from the accepted course of judicial proceedings, that a review by this Court is required.

The *Culbertson* case was argued before this Court on February 7, 1949, but has not yet been decided. If the Court affirms that decision, or if it accepts the legal theory advanced in the brief of *amicus curiae,* then the pres-

ent case must be reversed. Basically, the Tax Court committed the same error in the *Culbertson* case as it did here. In that case, however, the ultimate fact of "reality" could only be inferred from the record or read between the lines of the Tax Court's findings of fact. Perhaps in that case the Court of Appeals should not have made its own determination as to that ultimate fact, but should merely have remanded for a determination under correct legal principles. In the present case, however, the Tax Court's own findings could scarcely be more explicit on the question of the *bona fides* and "business purpose" of the partnership. If the court had felt free to decide the case on the basis of over-all "reality", there could be no doubt but that the decision would have been for the petitioners. The actual decision can be explained only by the narrow "capital and services" interpretation of the *Tower* case to which the Tax Court has restricted itself. The present case truly represents the *reductio ad absurdum* of that interpretation. If this Court announces that the *Tower* opinion was not meant to be so narrowly construed, then this case should be decided for the petitioners on the findings as made.

Because the decision in this case is in conflict with principles announced by this Court and by other Courts of Appeal, and because these principles are of great importance in the administration of the federal tax laws, it is respectfully requested that certiorari be granted.

Respectfully submitted,

MARK H. JOHNSON,
Counsel for Petitioners.

Of Counsel:

JACOB RABKIN.

May 16, 1949.

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ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 4-13) is a memorandum opinion and therefore

not officially reported. The *per curiam* opinion of the Court of Appeals (R. 56) is reported in 172 F. 2d 389.

JURISDICTION

The judgments of the Court of Appeals were entered on February 15, 1949. (R. 57, 58.) The petition for writs of certiorari was filed on May 16, 1949. The jurisdiction of this Court is properly invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's finding that the respective wives of the two taxpayers involved in these appeals may not be recognized as partners for federal income tax purposes.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit,

or gains or profits and income derived from any source whatever. * * *.

* * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. 1946 ed., Sec. 182.)

STATEMENT

The facts, as found by the Tax Court (R. 6-11) may be summarized as follows:

In 1929 Leon Fainblatt, one of the two taxpayers in the present cases, established a business for the manufacture and sale of women's and children's sport clothing. In 1934, he and his brother, Irving, the other taxpayer here, and their sister, Margaret, formed a partnership which they called Lee Sports-

wear Company, hereafter called Lee, to conduct the same business. All three devoted all their time to the business. (R. 6.) About this time Margaret married Harry Horowitz who was employed by Lee as production manager and who later became dissatisfied with his arrangement with Lee, whereupon it was agreed that he should become a partner. (R. 7-8).

It was agreed to establish a partnership composed of the taxpayers and Margaret as general partners, and their respective spouses as special or limited partners. On November 1, 1940, the taxpayers, their sister, and their spouses entered into a written agreement creating the partnership and filed a certificate of limited partnership with the appropriate authorities. (R. 8.)

The agreement recited that the general partners had carried on the business of manufacturing ladies' and children's apparel under the name of Lee Sportswear Company; that the limited partners would be admitted into the partnership as therein provided and that the investment or capital of the old partnership was $126,000. The agreement then provided that the new partnership was formed to carry on the business under the same name and at the same place as the old; that each general partner transfer and assign $21,000 to his or her spouse as a limited partner; that each partner should be "deemed to have contributed an equal 1/6th share thereof" and should receive 1/6 of the net annual profits; that all losses should be borne

equally but that the limited partners should suffer no loss in excess of their capital and should not be liable for any debts of the partnership; that the general partners should devote their entire time to the business; that the limited partners should have no part in the management, no power to bind the partnership and no right to withdraw capital prior to the dissolution of the partnership; that the partners would not sell or encumber their interests and that each general partner should be entitled to receive a minimum annual salary of $5,000. Further provisions related to access to the firm's books, retirement or death of a partner and procedure upon the termination of the partnership. The father of the taxpayers was designated as the final arbitrator of disputes among the partners. (R. 8-9.)

Upon the execution of the partnership agreement of November 1, 1940, the books of the old partnership were closed and books were opened for the new partnership. No cash passed from the taxpayers and Margaret to their respective spouses. The new books showed a capital account of $21,000 for each partner. (R. 9.)

Each taxpayer and Margaret filed a gift tax return reporting a gift of 1/6 interest in the partnership capital. Lee's bank was informed of the changes in the partnership status. Neither Aida Fainblatt nor Dorothy Fainblatt, the wives of the taxpayers, rendered any substantial service to the partnership business. Aida Fainblatt, Dorothy

Fainblatt and Harry Horowitz put no additional money into the business. (R. 9.)

The taxpayers and Margaret and Horowitz have drawn equal salaries during the taxable years and no bonuses have been paid to them. All partnership profits have been credited equally to the six partners. The amounts received by Aida Fainblatt and Dorothy Fainblatt were deposited by them in their own separate bank accounts. They have made their own separate investments. Their husbands have furnished all the money for the household expenses. (R. 9-10.)

Apparently, each of the partners, including the two taxpayers, returned 1/6 of the partnership profits; but the Commissioner determined that the net income from Lee should be divided equally among the two taxpayers and Margaret. (R. 11.) The taxpayers and Margaret appealed to the Tax Court which decided that Horowitz should be recognized as a partner, and that during the taxable years Lee was a partnership consisting of the two taxpayers, Margaret and Horowitz, whose respective shares of the earnings were 1/3 to each of the taxpayers and 1/6 each to Margaret and Horowitz, her husband; the wives of the taxpayers were not recognized as partners for federal income tax purposes. (R. 11, 12-13.) The taxpayers appealed to the court below [1] which, in a *per curiam* opinion, affirmed the decision of the Tax Court. (R. 56.)

[1] No appeal was taken by the Commissioner from that part of the Tax Court's decision holding that Horowitz was a 1/6 partner.

ARGUMENT

The present cases are controlled by *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, which involve facts similar in all essential respects. Accordingly, there is no occasion for further review.

The Tax Court's decisions, which were affirmed *per curiam* by the court below, announced no principle or rule of law at variance with the *Tower* and *Lusthaus* decisions; on the contrary, the opinion of the Tax Court discloses a correct understanding of the principles of those cases and a discriminating application of those principles to the present cases with consideration being given by it to all of the relevant facts. This is demonstrated by the differentiation made by the Tax Court between the status of Harry Horowitz, husband of the present taxpayers' sister, and the status of the respective wives of the two taxpayers here involved.

Prior to being taken into the partnership in 1940 as a limited partner, Harry Horowitz rendered substantial services to the business in various important capacities. (R. 7.) From time to time he was offered more lucrative connections by other manufacturers (R. 7), and the Tax Court found (R. 8) that the formation of the 1940 partnership was prompted solely by the insistence of Horowitz that he should have a position in the company comparable with those offered to him by other manufacturers. The Government did not seek review

of the Tax Court's finding that Horowitz was a *bona fide* partner for federal income tax purposes.

The situation as it pertained to the respective wives of the present taxpayers was in marked contrast to the situation of Harry Horowitz. Although the entrance of the wives into the firm may have grown out of the emergent necessity of including Harry Horowitz therein, the Tax Court has correctly found (R. 12) that it was not supported by the same basic consideration. While all members of the family were anxious to retain Horowitz' services, his wife, Margaret, felt that by transferring to him half of her interest she would not have an equal voice with her brothers, the taxpayers, in the management of the company and that the only solution to the problem was for the taxpayers to turn over half of their interests to their wives, in order to equalize her position with those of the two taxpayers. (R. 8.) The taxpayers' wives, however, were expressly excluded from any voice in the management of the partnership (R. 9, 12), and the only pertinent result of their admission to the partnership was that the taxpayers and their sister continued to possess after the formation of the new partnership the same control which they had possessed prior to its formation, a result which might well have been accomplished by a simple rewording of the partnership agreement, without attempting to include the taxpayers' wives in the partnership.

Not only did the wives have no voice in the management of the partnership; they performed no appreciable services for it, and they contributed no capital originating with them to the business. They knew little or nothing about its operation and merely "did as they were told." (R. 12.) These facts, the Tax Court correctly held (R. 12-13), follow closely the pattern of the *Tower* and *Lusthaus* cases, and fully justify the conclusion of the Tax Court that the inclusion of the wives in the partnership did not alter the economic status of the taxpayers as part producers of the income. Further support for the Tax Court's conclusion may be found in the fact that the partnership agreement provided that the wives of the taxpayers [2] should not be liable for any debts of the partnership; that they should suffer no losses in excess of their capital; that they should have no power to bind the partnership, no right to withdraw capital prior to the dissolution of the partnership, and no right to sell or encumber their interests. (R. 8-9.)

The present cases are essentially no different from numerous other partnership cases in which income ascribed to a donee-partner has been held taxable to the donor-taxpayer, and in which certiorari has been denied. The pendency of *Commissioner* v. *Culbertson,* No. 313, present Term,

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[2] These provisions also applied to Harry Horowitz and constituted in part the basis for the Commissioner's position that Horowitz was not a *bona fide* partner for income tax purposes.

does not require a review of the present cases. See the respondent's briefs in opposition in *Kohl* v. *Commissioner* and *Moore* v. *Commissioner,* Nos. 509 and 525, respectively, present Term.

CONCLUSION

The present cases are controlled by the *Tower* and *Lusthaus* decisions, and there is no occasion for further review. The petition for writs of certiorari should be denied.

Respectfully submitted,

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JUNE, 1949.

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